L. R. B. & M. JOURNAL

VOLUME 10 NUMBER 5

SEPTEMBER, 1929

Published by

LYBRAND, ROSS BROS. & MONTGOMERY

Accountants and Auditors

L. R. B. & M. JOURNAL

VOLUME TEN | SEPTEMBER, 1929 | NUMBER FIVE

Budgets—Their Organization and Administration *

By GEORGE R. KEAST

In preparing this article I searched for a concise definition of a budget but I was unable to find one that I liked. The Financial Handbook, edited by Colonel Montgomery, says:

> "The business budget is a modern adaptation to business of an ancient method of controlling public or social receipts and expenditures. It is one of the rare instances in which the business man has been able to learn something from the politician....
>
> "The budget is prepared from estimates or forecasts, for a definite future period, of the expected operations in each functional department of a business. The forecast of each department is dependent upon the anticipated activities of all other departments; for example, a manufacturing program must be based upon expected sales and the estimate of sales is limited by the producing capacity of the factory."

My objection to this and other definitions of budgets is that they are too long. Perhaps the trouble is that the subject is too vast and that it has too many ramifications to define it briefly. Nevertheless, I would define a budget as *a plan to control the operations of one or more departments of a business for a future definite period.*

The most ardent advocates are very careful to point out that a budget will not take the place of brains in a business. At best, it is but a tool for the use of the management and as such it must be designed to fit the needs of the business. Since even in the same industry no two businesses are organized exactly alike, it follows that budgetary control is applied in almost as many forms as there are businesses using it. For this reason, in discussing budgets it is customary to describe the application to a specific business or industry. The speakers who follow me on the program today will tell how they use budgets in their own particular business. For that reason I have been requested to discuss fundamentals.

In the November issue of *Nation's Business,* published by the United States Chamber of Commerce, there is an article entitled "Theories! Yes, and They Worked," by Hiram S. Brown. Hiram S. Brown was asked by the U. S. Leather Company to find out what was the matter with the leather industry that it was not earning money. He studied the situation and presented his report. He was invited to head the company and put his theories to work. In the article he tells just what he did and why. Among other things he says the budget system of operating and financial control was introduced based upon sales, current levels of prices, and costs as worked out, revised from time to time by modern methods of market analysis to keep it in accord with the changing conditions and prices. These budgets serve as sales quotas for a study of the trends of conditions in the company's markets; as a guide for purchases; and for inventory control. He instituted a system by which the company's statistical organization con-

* An address delivered at the Pacific Coast Conference of the National Association of Cost Accountants.

stantly studies and reports upon world and domestic conditions affecting the industry.

When he took the job as president of the U. S. Leather Company in August, 1925, there were over $22,-000,000 of bonds outstanding and inventories, he says, were tremendous. In conclusion, the article states that the $22,000,000 of bonded debt has been wiped out; the loans have been paid off; the company does not owe a dollar; and instead of a deficit, made a net profit of $3,600,000 in 1927 and a net of $3,000,000 for the first half of 1928.

Undoubtedly, part of the credit for the accomplishment may be ascribed to the adoption of complete budgetary methods of control.

Permit me to emphasize the salient features of this story;

First: Mr. Brown studied the situation. Before doing anything he analyzed the Leather Company's needs and obtained accurate, detailed and unprejudiced knowledge of the business and its surrounding conditions.

Second: He installed a system of forecasting results based upon estimates of sales which were revised from time to time by modern methods of market analysis to keep the company in accord with changing conditions.

Third: The results show that the estimates were enforced. The mere gathering of data or preparation of estimates is only a step in the right direction. Having made a budget based upon current possibilities, Brown saw to it that the possibilities were converted into actualities. Theories or facts—it is putting them to work that counts.

Mr. Queen, of our staff, told me that the office manager of a medium-sized firm once attempted to install a budget. He started three months before the end of a year and finally in early December threw up his hands and called for professional assistance. A survey of the situation revealed a room with several tables on which were filing racks with an elaborate system of Dewey decimal classification. In each rack were neatly typed sheets further breaking down the classification into the most minute detail. On each sheet were figures showing the previous expenditures. Yet the heartbroken office manager realized that the president of the company had been correct in saying:

"This may be a budget, John, but I'll be darned if I know what we are going to do with it."

There is undoubtedly a popular tendency to confuse the mechanical details of budget procedure with the more basic features of budgetary control. Yet it must also be admitted that lack of proper procedure in budget operation can easily defeat its major purposes.

One of the debates before the San Francisco Chapter some years ago brought out a certain degree of skepticism about budgetary control because it involves estimating or forecasting. There is still perhaps a somewhat general feeling that one must acquire a degree of clairvoyance to be a successful "budgeteer." Yet to the extent that you cannot forecast or estimate in advance you cannot provide or plan intelligently, and business becomes more or less of a gamble against unknown odds. Estimating or forecasting involves the application of judgment and ordinary reasoning processes to facts. It may involve actuarial computations.

It may utilize charts, graphs, and curves and formulae, or it may be the simple average of the judgment of several informed persons. There is a best and most practical method for every situation that will contribute to its effective control and whatever the deficiencies of the plan may be it is certainly better than no plan at all. For many years accountants have been budgeting bad debts, depreciation and other items, and have demonstrated that sound forecasts can be made and safely used in accounting. Many businesses have demonstrated the same thing with respect to other items.

Organization for Preparation of the Budget: The prerequisites or first essentials in budgeting any business are:

First: Adequate knowledge of the conditions surrounding the business and its internal operation to permit of an orderly and progressive analysis of its requirements and the causes of variations therein.

Second: A good accounting system.

Third: A sound organization plan coordinating the personnel and the physical factors of the business.

These three prerequisites are required to make possible or effective the three phases of budgeting, viz.:

1. The preparation of estimates which in turn become approved plans for the future.

2. The mechanical operation of the budget procedure.

3. The administration or application of the budget to effectively control the results from operations.

These will be discussed briefly in the order named.

I. The Preparation of Approved Plans

Budget Period: Before making any estimates it is necessary to decide upon the length of the budget period. This will depend upon the factors affecting the business, but in every case sufficient time must be allowed for financing, purchasing, production, and distribution. In a seasonal business the budget period should be long enough to include the months of greatest activity and those of comparative dullness. When it is difficult to plan ahead because of peculiar conditions affecting the business, a short period must be used. A short period is objectionable because it may not provide for planning far enough ahead to get the best results. While a long period is desirable, it is open to the objection that it is more difficult to plan the details of operations over a long period. The objections to the short and long budget periods may be overcome by making detailed plans for the immediate future and general plans tentative in nature extending over a year or more. The American Telephone and Telegraph Company, the largest public utility organization in the world, makes a forecast for a period of five years.

Sales Forecast: The sales quota is the foundation of the budget plan of every business in which sales are a function. The first question, therefore, is what will be the demand for the output. The answer depends upon a number of factors. One of the most important is the relationship of the demand for the product to general business conditions and purchasing power. This can be determined by a comparison of sales in the past with the curves of business conditions pub-

lished by statistical organizations. Through the Survey of Current Business, published by the Department of Commerce, the public now has the benefit of over 1,500 separate indicators of business trends. It also receives more specialized information on agriculture through Crops and Markets, published by the Department of Agriculture; on labor statistics through the *Monthly Labor Review*, published by the Department of Labor; and on general financial and business data in the Federal Reserve Bulletin, published by the Federal Reserve Board. The monthly bulletins of the Federal Reserve Banks and the publications of the individual trade associations furnish additional information.

The Walworth Manufacturing Company, manufacturing pipes and fittings, and producing over 20,000 different articles, has had notable success with its budget. The sales quotas for the individual branch offices are established for one year in advance by the branch managers in consultation with their sales forces.

This company keeps forecasting charts for each class of goods it makes. These forecasts are each composed of four charts; one shows the gross orders received; the second, the normal seasonal conditions; the third, an elimination of the seasonal and normal growth, together with a correlating index; and the fourth, the actual orders as a percentage of those received the preceding year. The correlating index in the third chart is composed of the statistics of a number of industries, properly weighted, which are shown by experience to have the closet advance correlation to the particular product for which the chart is made. The first year the budget was in effect sales were within one per cent of the sales forecast. This shows what can be done.

The Burroughs Adding Machine Co. based its estimated market for setting sales quotas on a count of enterprises in the United States that might be potential buyers of its product.

Here's a list of factors considered by a motor truck company in setting its sales quotas.

1. Population.
2. Estimated sales expense.
3. Minimum volume of business required to absorb the sales expense.
4. Percentage of total direct sales made by the company during the preceding year.
5. Volume of business each preceding year.
6. Average annual percentage of increase.
7. Estimated increase for the coming year.
8. Estimated number of sales to be made through old dealers.
9. Estimated number of sales to be made through new dealers.

One of the large electric companies does not use records of previous years to any extent in setting sales quotas. Conditions existing both in the plant and in the industry are the main guides in the setting of sales quotas which are based upon the salesman's estimate of the sales he expects to make in each line of the company's product.

Several companies having a national distribution base their sales quotas on the circulation of the *Saturday Evening Post*.

They distribute the quota according to counties and cities by dividing the total number of machines they want to sell per month into the number of

Posts sold per week for the entire country. The common divisor thus obtained is divided into the circulation for any city to arrive at the number of machines per month as a quota for that city.

Various forms of published statistics, stock exchange quotations, bank clearings, interest rates and similar data are in general use and unless the product is special in nature some fairly reliable means exists for forecasting the sales.

As soon as the sales estimate is available it must be considered in its relation to the following principal factors: first, plant capacity; second, margin of profit both gross and net; and third, financial requirements.

With regard to plant capacity it is obvious that a sales program in excess of the plant capacity cannot be adopted. It is, therefore, necessary to obtain data which will show production capacity, and using this as a basis determine whether the quantities called for by the estimate can be produced.

The margin of profit requires careful consideration. We are all in business to make money and no one wants to sell an article which does not yield a satisfactory profit. Competitive conditions, however, may make it necessary to sell certain items at little or no profit or even at a loss in order to present a complete line of goods to the public. But certainly every effort should be made to reduce the number of unprofitable items.

In considering the relation of the sales estimate to profit the effect of changes in method or in the volume of sales must be taken into account. Such changes may have a material effect on the cost of production and selling and administrative expenses.

Probably the most important point to be kept in mind in making over the sales estimate of volume into a sales program is the necessity of providing the maximum profit that trade conditions will permit consistent with the permanency of the business. This comment applies to the net as well as to the gross profit. Careful consideration must be given to the effect of the selling, administrative and general expenses that will result from the adoption of the sales estimate.

After the sales estimate has been revised in the light of plant capacity and profits, it is possible to estimate the financial requirements. A further revision of the sales estimate is necessary if the amount required is in excess of the financial resources of the business.

Other Forecasts: The forecast of each department is dependent upon the anticipated activities of all other departments; thus, in a manufacturing business, the sales forecast is the basis for the production forecast. The quantity of finished goods to be produced is fixed by the amount to be sold, plus or minus the increase or decrease in the inventory of finished goods at the beginning and end of the budget period. This forecast, in turn, determines the number of workmen that will be required and is the basis of the forecast of the salaries, wages and expenses that will be incurred by the manufacturing program. In connection therewith, inventory and material controls should be established so that finished goods will be on hand in time for delivery and purchases will be made as needed and not before. The cost of

plant and equipment required by the manufacturing program must be ascertained, and selling, administration, and general expenses must also be budgeted in relation to the forecasts of the other departments.

After estimates have been made for all departments, the Treasurer will prepare an estimate of the cash receipts and disbursements for the budget period based upon the departmental estimates. At this point a further revision of the departmental estimates may be necessary to bring them into harmony with a workable financial program.

Applying all of the forecasts to the balance sheet at the beginning of the budget period will produce an estimated balance sheet as at the end of the period and an estimated profit and loss account. There is the picture. Now is the time to correct it if it is unfavorable.

II. The Operation of the Budget Procedure

In large plants or institutions the procedure involved in the preparation and execution of the various departmental budgets is often a comprehensive and complex one. As shown by the discussion, it requires the close cooperation of the executives and the coordination of the activities of the functional departments.

Most of the literature on the subject deals with budgets from the standpoint of large concerns. It may be well to point out that the apparent complexity in such cases is due to the magnitude and diversity of operations. There is no reason why a budget should be unduly complicated. Simplicity of procedure should be given special attention. In small or medium-sized plants it is posible to introduce budgetary control with very little additional effort provided the prerequisites previously mentioned exist.

A common mistake in smaller concerns is to attempt to adopt or introduce a scheme of budgetary control based upon that in use in a larger plant or firm with perhaps many distinctly different requirements.

Since the success of the budgetary program is dependent upon cooperation and coordination, it is desirable to reduce the budgetary procedure to writing so that all executives and employees concerned will have it available for guidance.

The manual of budgetary procedure should be confined to the procedure involved in the interdepartmental relations arising from the budgetary program. It should not attempt to outline in detail the procedure to be followed by each department in the preparation of its estimate or the carrying out of its budget. It should schedule the reports required and the dates they are to be submitted.

All departmental estimates must conform to the classification of accounts in use so that comparisons with actual results can be readily made.

III. Administration or Application of the Budget to Control the Results from Operations

The person in charge of the budget procedure should be someone intimately acquainted with the affairs of the company and its operating problems. Conditions, of course, vary the requirements, but speaking generally the heads of the various departments, the men who have been responsible for the estimates, should constitute a

(*Continued on page 24*)

International Congress on Accounting

By H. E. Bischoff and N. B. Bergman
(*New York Office*)

The third International Congress on Accounting, sponsored by the American Institute of Accountants, American Society of Certified Public Accountants, National Association of Cost Accountants, American Association of University Instructors in Accounting, and the State Societies of Certified Public Accountants in the United States, was held September 9 to 14, 1929, at the Hotel Commodore in New York City.

The Congress was opened by an address of welcome by Colonel Montgomery, the President of the Congress. The Honorable Herbert H. Lehman, Lieutenant Governor of the State of New York, delivered a speech of welcome to the delegates and made some interesting observations on accountancy from his point of view. The Honorable James J. Walker, Mayor of the City of New York, also delivered an address of welcome to the City of New York, at which time the Honorable Grover A. Whalen, Police Commissioner of the City of New York and Chairman of the Mayor's Committee on Reception to Distinguished Guests, likewise addressed the Congress and made mention of the permanent benefit he had derived from the experience in accounting which he had gained in his earlier business life.

This Congress can truly be said to have been the most significant gathering which has ever been held in the history of the profession. Numerically, the attendance, which was representative of the profesion in many different sections of the world, exceeded the second International Congress on Accounting, which met in Amsterdam, Holland, in 1926, by approximately 2,000, and it exceeded the first Congress which was held at St. Louis in 1904, by approximately 2,300.

The preliminary arrangements, the conduct of the proceedings, and the social features provided, which made the Congress an outstanding success, required the untiring efforts of a considerable number of members of the profession who gave of their time most unsparingly. Colonel Montgomery and other members of the committees entrusted with the preliminary arrangements attended personally to an enormous amount of detail.

The papers presented and discussed at the Congress were grouped under the following general headings:

Monday: Development of Professional Accounting in Continental Europe.
Legislation Affecting Accounting in Private Industry for Tax Purposes or in Mergers or Cartels.
Legislation and Education for the Accounting Profession.
Educational Activity in Accounting and Statistical Work.

Tuesday: Theories of Depreciation.
Problems of Depreciation and Obsolescence.

Wednesday: Principles of Valuation.
Balance Sheets.
Consolidated Financal Statements.

External Influences Affecting Accounting Practice.
The Accountant's Responsibility for the Inventory.

Thursday: Cost Accounting.
Accounting for (a) Materials, (b) for Labor, and (c) for Burden.
Standard Costs.
Distribution and Selling Costs.

Friday: Commercial Budgetary Practice.
Municipal and Governmental Budgets.

Saturday: The Natural Business Year.
The Thirteen-Month Year Calendar Reform.

The papers written for the Congress had been translated into English, French, and German, and had been distributed to the various members of the Congress for perusal and study. At the Congress the papers were commented upon by individuals who had studied the papers and in each case the author, or in those few instances in which he could not be present his representative, made answer to criticisms or summarized his paper.

Our firm was represented not only by Colonel Montgomery, who was President of the Congress, but also by the authors of two of the papers presented, i.e., "Consolidated Financial Statements," by Mr. Walter A. Staub, and "Accounting for Burden," by Mr. Walter S. Gee. The subject of "Consolidated Balance Sheets" was dealt with in an instructive paper by Mr. William Cash, F.C.A. of London. The latter took occasion to remark before the Congress that Mr. Staub's paper was an extremely valuable and constructive contribution to the subject of accounting and one of the outstanding papers presented at the Congress. Mr. Gee's paper evoked considerable favorable comment.

One of the early numbers on the program of the Congress was the awarding of the prizes in the essay contest which had been arranged for members of the staffs of public accounting offices. Of especial interest to the L. R. B. & M. organization is the fact that Mr. Myron J. Boedeker, of our Los Angeles office, received First Honorable Mention.

Although the major portion of the time had to be devoted to the presentation and discussion of technical subjects, nevertheless those attending the Congress found themselves royally entertained by the various organizations which sponsored the meeting. On Sunday, September 8th, the foreign members and their ladies were entertained by Colonel and Mrs. Montfomery at "Wildacres," their country home. Luncheons to the foreign members and ladies were sponsored by the various accounting organizations each afternoon. Sightseeing trips around New York, and visits to Columbia University, New York University, to various industrial establishments and to other places of interest to accountants were arranged for and highly enjoyed by all who attended. One of the most interesting occasions arranged for the ladies was a Fashion Show and tea at Wanamaker's.

On Tuesday evening, September 10th, a reception and banquet was held in the Grand Ballroom of the Hotel Commodore, for the members of the Congress, and ladies, sponsored by the New York State Society of Certified Public Accountants. A goodly num-

(*Continued on page 23*)

Should the Plant Account Be Written Down to $1?*

By MYRON J. BOEDEKER

(*Los Angeles Office*)

The trend of corporate laws governing the use of capital stock without par value is more and more toward liberality and absence of restraint. The ultimate in freedom from restriction seems to have been reached in the Delaware corporation law which became effective March 22, 1929. Section 14 of that law provides, among other things, that the Board of Directors of a corporation may, by resolution, determine that only a part of the proceeds of sale of its no par value stock shall be capital. The excess of net assets of the corporation over the amount so designated as capital shall be surplus. The law specifically permits the payment of dividends out of such surplus and apparently allows its treatment and use in every way as free surplus. This phase of the law has already been discussed editorially in the June, 1929, issue of the *Journal of Accountancy*.

One of the developments made practicable by this law has extraordinary possibilities. The directors of a new corporation may designate a large portion of the proceeds of sale of stock as surplus and immediately write down fixed asset values to a nominal sum. The balance sheet then carries plant and equipment, buildings, patents, goodwill, and other fixed assets at nominal values. Part of the paid-in surplus has been wiped out. The income account includes no charge for depreciation of plant and equipment, or amortization of patents, since there is no book value of such assets to be written off against operations.

Unquestionably such a practice will meet with strong opposition from many quarters. Just as certainly, however, it will find staunch supporters. The purpose of this paper is to present the question, state the arguments which may be made in favor of the practice, and point out the stand which the accountant is justified in taking, together with objections which he may make to the procedure.

The question may be considered from three angles, namely: the effect upon asset valuation in the balance sheet; the effect upon fixed charges in the operating statement; and the effect upon the capital or net worth of the company.

Effect Upon Asset Valuation

In considering the effect on the balance sheet, it seems advisable to sketch the mechanical steps in the accounting procedure which carries out the plan. It is contemplated that complete property records will be kept, with asset accounts showing cost of properties and offsetting accounts for depreciation reserves in the customary manner. Depreciation is to be computed periodically and added to the reserves. A special account or valuation reserve would be created out of paid-in surplus and carried in an amount which offsets the net book value of the assets, leaving a balance of $1.00 as the nominal sum

* See editorial note on page 23.

to be shown on the balance sheet. As depreciation is credited periodically to reserve accounts, the corresponding charge is made to the valuation reserve instead of to operations in the ordinary manner, so that at all times the net value remains unchanged at the nominal sum of one dollar.

The same information is available from these records as would be shown in the usual set of accounts. There should be no difficulty, therefore, in preparing the income tax return so as to include the allowable depreciation and amortization which is deductible in ascertaining net taxable income even though not included in expenses upon the books.

As to the theory involved in the procedure, the first point advanced in its favor is that an accepted and approved accounting practice is being logically carried one step further than has been customary in the past. It has long been considered good practice to write off the cost of patents, copyrights and goodwill against surplus, carrying them upon the balance sheet at $1.00. Accountants have approved the practice as conservative and desirable. They have not considered it necessary to call attention to the procedure by a footnote upon the balance sheet, nor have they felt impelled to qualify an income account with the notation that earnings are shown before amortization of patent costs which have been written off against surplus.

With a procedure recognized as sound and conservative in connection with intangible assets, is there any essential reason why the theory is not equally sound when applied to tangible fixed assets? Both tangibles and intangibles are capital assets of the company; both have (with few exceptions) limited useful lives; both may be essential to the success of the enterprise; and both derive their real value to the business as a going concern from their usefulness or earning power rather than from salability. It seems logical, therefore, to conclude that a theory which is sound in connection with intangibles is sound when applied to tangibles, and, conversely, if the theory proves unsound when applied to tangibles it cannot be sound in dealing with intangibles. It may be that we must either admit the correctness of valuing fixed assets at a nominal sum, with a corresponding elimination of depreciation charges, or recognize as unsound the nominal valuation of patents, with its corresponding elimination of amortization charges.

The nominal valuation of such intangibles as patents, copyrights, trademarks and goodwill is based upon two primary considerations. First, such assets are regarded as particularly susceptible to obsolescence and fluctuations in value resulting from many influences both within and without the business. There is considered to be an unusually high element of uncertainty inherent in them. Second, the true value of such assets is measured by the capitalization of earnings attributable to them regardless of their book value.

Reduced valuation of plant assets is based upon a broader application of the same fundamental considerations. Proponents of the practice submit that the useful value of plant assets is also subject to fluctuation due to obsolescence or outside influences, and, particularly in cases where the business is protected by valuable patents, the same factors which would destroy

the value of patents might reduce the useful value of plant assets to scrap or resale value, as production is cut down or discontinued. It is also submitted that the true value of any capital asset to an organization as a going concern may be measured by capitalization of earnings attributable thereto, and this true value must be recomputed from time to time as conditions change. No permanent book figure can express this value at all times.

The theory of asset valuation upon the basis of capitalized earnings is itself a theme for much discussion and cannot be dealt with at length here. It may be said, however, that while a corporation's plants, goodwill, and other fixed assets may not always be accurately valued by capitalized earnings, the underlying principle is sound. An illustration will bring out the point. Capitalization of the earnings of a large paper manufacturing corporation operating numerous plants, some profitable but many unprofitable, would have resulted in the valuation of a number of plant units as minus quantities. It was not that these assets were worthless, but that conditions for the company as a whole could not improve until many of the plant units were eliminated. While not without value in one sense, they were very much in the nature of liabilities to the operating organization, acting as a drag upon the earnings of the profitable units. A minus quantity expressed their value to the company as a going concern much more accurately than the ordinary book value of cost less accumulated depreciation.

Furthermore, the book value of plant assets bears no necessary relation to going concern valuation, reproduction cost, fair market value, or scrap value. Book value is a figure practically devoid of significance. This being the case, it is perhaps preferable to show a nominal figure for fixed assets upon the balance sheet, thus stating, in effect, that the reader must determine his own valuation, guided by circumstances at the time and by the purpose for which he intends the figures. Such responsibility, to determine true value, rests with the reader of a balance sheet prepared upon the ordinary basis. In reading the customary balance sheet, however, the unwary may easily be misled by the stated book value which the initiated recognize as being only historical information, not always even historically accurate.

The writing down of fixed assets to nominal values has particular advantages for companies in especially hazardous lines of business, where sudden changes may materially affect production and sales, or where the factor or threat of obsolescence is great. In such cases, the plant assets may shrink so materially in value to the going concern that they closely approach the nominal value shown in the balance sheet. If the reduction in value has already been provided for, however, and the loss absorbed in the net worth, the shock is taken up with a minimum of disturbance to the financial structure. In effect, a 100% reserve for obsolescence and contingencies is provided at the outset and is available throughout the entire actual life of the asset.

Effect Upon Income Account

From the standpoint of the income account the principal question is: Can earnings be correctly stated if no depreciation charge is included therein?

Here, as in the balance sheet, we find the procedure not so radically different in theory from other accepted practices. It is identical with the situation resulting from carrying patents at nominal values. It is identical in effect with the situation which arises when, as a result of an exceedingly liberal depreciation policy, plant assets have been fully depreciated upon the books before their actual useful life is over.

The proposed procedure is closely allied to another familiar and accepted situation. Accountants and investment bankers are accustomed to the reorganization in which plant assets are written up to appraised values (stock being issued upon the basis of such values) and the value of the assets so determined subjected to periodic depreciation charges. The depreciation charges are larger than were incurred by the business before reorganization, and, as a result of excessive valuations placed upon the assets, may constitute an actual burden upon the earnings of the corporation. The practice may even be carried to such an extreme that each year's depreciation charge is in reality part depreciation and part reinvestment of earnings to take the place of water in the stock.

Such overvaluation of assets, and overburdening of earnings with depreciation charges, is open to charges of unsound financing and poor business, but the accountant is technically correct in accepting (if not, indeed, required to accept) these valuations (as cost) and the depreciation based thereon. The statistician and analyst, in comparing progress of the reorganized company with the record of its predecessor, may point out the difference in net profit resulting from increased depreciation, but the accountant is not expected to call attention thereto in his certificate. To him the unamortized or undepreciated cost (however determined as between the old and new companies) is a definite figure which he shows in the balance sheet, and depreciation (correctly computed at a reasonable rate) is also a definite sum which he shows in the income account. Further than that he cannot be expected, nor, in some cases, may he even be permitted to go.

If it is permissible in connection with a reorganization to write up assets and increase depreciation accordingly, is it not equally allowable, at the time of organization or reorganization, to write down assets even though one result is to decrease or eliminate depreciation charges? In each case certain legal and technical requirements are properly met, and a set of facts provided upon which future financial statements must be based. If the write-up of assets is permitted, even though it results in enlarged depreciation and correspondingly decreasing profits, then the write-down of the assets cannot be condemned merely because it has the opposite effect of reducing depreciation and increasing profits.

It may also be argued that depreciation must not necessarily appear in operating costs because physical deterioration actually takes place. Through the action of the directors, who represent the stockholders, the corporation has secured the advantage of reductions in future operating costs as compensation for the immediate elimination of assets and reduction of surplus in the balance sheet.

Special advantages which result in showing larger earnings than would

be realized under ordinary circumstances are not uncommon. An individual proprietor incorporates a business which he has operated for many years. Not being interested in marketing stock, he turns over his assets to the corporation at their then book value, which in the case of plant and equipment is far below market or replacement value at the time of incorporation. Another corporation, identical in all respects, save that its plant and equipment are acquired at market value for cash, will show heavy depreciation charges. The first concern will show small depreciation charges and correspondingly larger profits, yet its operating statement is none the less correct because of the advantage under which it secured its plant and equipment.

A stockholder, to assist a business in which he has invested heavily, lends its funds without interest. Can it be claimed that the income account should show a theoretical interest charge even though the particular funds are borrowed by the stockholder individually and there is, therefore, an actual expense incurred by him for the use of the funds? Again, if a concern accepts the rent-free use of factory premises for a certain time, the offer being made as an inducement to persuade the concern to establish itself in the community, is it either necessary or correct to include a rental charge operating expense when in fact no such expense is incurred? The business is enjoying a special advantage which has a direct effect upon profits.

Also, suppose that stockholders in a certain corporation own valuable patents under which they license other corporations for substantial royalties. To their own company, however, they wish to give a competitive advantage and, therefore, allow it free use of the patent rights with the knowledge that the dividende return will compensate them for royalties foregone. Would there be criticism under such circumstances of the accounting procedure which shows no value for patent rights upon the corporate balance sheet and no charge for royalties in the operating statement? Yet is not the situation analogous to the exclusion of depreciation through the placing of a nominal value upon plant assets? In both instances the stockholders have contributed the use of valuable, wasting assets; in neither case is the corporation required to defer charges or costs to operations because in neither case is there an unamortized asset value to be charged against operations of future periods.

In the case of the write-down of assets to a nominal value, with the offsetting charge against paid-in capital, the stockholders have, in effect, granted the corporation the right to use plant and equipment without cost to it. Since their capital is not replaced in the business through periodic charges to operations, they are themselves bearing the loss or expense resulting from shrinkage in value due to depreciation just as, in the last illustration, the stockholders sustained the loss due to expiration or obsolescence of the patent. This may or may not be good business or an advisable procedure. That question is for the stockholders to decide. Having decided, the facts exist and must be so recorded. Financial statements must necessarily reflect the facts.

Viewing the matter in its relation to

cost accounting, it may be said that, if cost as developed by a factory cost system, with no depreciation included, is used as the basis for establishing selling prices (although competition will ordinarily determine prices) there is danger that such prices may be set so low as to give less than sufficient income to provide for replacement of fixed assets and a fair return on capital.

The objection cited is identical to that raised in connection with costs which do not include interest on investment. It is true that selling prices, if based upon costs, cannot be set fairly unless both interest on investment and a provision for depreciation or replacement are considered. It is well established, however, that this consideration does not necessitate the inclusion of theoretical interest in the operating statement. It is equally true that a like necessity for considering replacement of plant does not require the inclusion of depreciation. The cost records may reflect the economic fact of interest and depreciation, without requiring a similar reflection in the operating statement.

All of the foregoing discussion has been aimed to show that earnings may be correctly shown under the procedure reviewed, without deduction for depreciation. If this practice is permissible it is probable that the liberal element in financial circles will make full use of the opportunity to increase the figure which may be published as earnings. It is equally probable, however, that the conservative element, who view the theory with favor on account of its effect in the balance sheet, will desire to place some degree of restraint upon the effect of the practice in the operating statement.

For the conservative group, several methods of procedure are open. The simplest consists of charging to operations all replacements intended to maintain the existing operating plant. Current earnings would, of course, bear the expense of ordinary repairs and, in lieu of depreciation, would also bear the additional cost of replacements to keep the plant value (or, more correctly, the operating efficiency of the plant) intact.

The objection to this procedure is in the irregularity of the replacement costs, which might produce undesirable fluctuations in profits between periods. A replacement reserve would overcome this condition. Operations of each period would be charged with a constant sum to be added to the reserve, and purchases of replacement units would be charged against the reserve as they were made. The effect of such a policy upon earnings would be practically identical with the present practice of charging depreciation. The difference would be one of nomenclature.

In connection with the balance sheet, it was suggested that, since book value of fixed assets is so lacking in real significance as to be at times misleading, there is an advantage in admitting this frankly and using a nominal value in the balance sheet. A parallel suggestion may be made with relation to the exclusion of depreciation or its related item of replacements from the operating statement.

Depreciation at best is but an estimate. In making the estimate, judgment is bound to be influenced by natural inclination toward conserva-

tism and caution or toward liberality and optimism, although good faith in either case may not be open to question Different types of management will follow varying depreciation policies, and widely differing results under identical circumstances may still be within the technical requirements of accountancy. The United States Board of Tax Appeals, for example, decides in one case that 10% is an allowable depreciation rate upon automobile trucks. In another case a rate of 20% is approved, also 25%, and finally 33 1/3%.

Obviously, there is a variable factor which disturbs comparison of parallel businesses whose depreciation policies may be dissimilar. Recognition of this fact at the present time is evidenced by the frequency with which published statements include a figure of net profit before depreciation. A question which may help to stimulate thought is this: is not a figure of earnings, stated frankly to have been determined without allowance for depreciation a more substantial result to deal with, and from which to draw conclusions, than one which purports to have made full allowance for depreciation and which may be accepted by the reader without inquiry into the depreciation policy, despite the wide range permissible and the peculiar factor of judgment entering into any determination of depreciation.

Effect Upon Net Worth

The question has been considered from the standpoint of the asset side of the balance sheet and of the income account. It should next be viewed with relation to the net worth or capital of the business.

The immediate effect of the charge-off or the asset values is a reduction in the net worth or stockholders' equity, as expressed in the balance sheet. This is of less importance than it would seem. If there is a figure which may be said to be the true net worth of a going business, it is certainly not the figure of net worth stated in a balance sheet prepared in accordance with recognized accounting principles nor upon the basis of the proposed procedure of valuation. The true net worth, or value of stockholders' equity, may be more nearly approached by the valuation placed upon the stock by prospective investors who give utmost weight to capitalized earnings not reflected at all in the balance sheet.

This being the case, the charge-off and exclusion from the balance sheet of a large amount of net worth should not affect a determination of the real value of the capital stock. It does, however, so alter the figures that the amount of paid-in capital contributed by the stockholders is no longer shown accurately upon the balance sheet. This happens also, of course, when goodwill or patents are written off against capital surplus and, since this objection is not ordinarily raised in such cases, it appears to have little significance in the case of write-down of physical assets.

More far reaching and important, however, is the possible effect of the payment of dividends out of the earnings as shown without depreciation charges. To consider an extreme case, assume that the plant assets are written off against paid-in surplus; that the full amount of earnings as stated without depreciation allowance is paid

out in the form of dividends; and that at the termination of the useful life of the assets, the business is wound up without sustaining losses upon liquidation. If the stockholders have expected their original investment to be repaid to them in liquidation, the final distribution will be disappointing, for it will be less than the amount paid in to the extent of the assets charged off against capital surplus. The stockholder then finds, in reality, some of the dividends which he believed to be profits upon his investment to have been a return of his capital.

Two principal questions are raised by such a situation. The first is concerned with the corporation's payment of dividends out of capital. The second has to do with the investor's receipt of dividends which are a return of capital.

Most of the present accepted theories in regard to payment of dividends, and the requirement that a corporation's capital must be kept intact, are so dogmatic and so universally agreed upon that little thought is given to the underlying fundamental principles. The proposition here discussed and the situations it creates suggest a number of points which, whether entirely sound or not, stimulate thought in a field too often viewed as settled. No attempt will be made to treat exhaustively the points raised. They will be stated and left with the reader for consideration.

First, it is submitted that dividend policy should not be based primarily upon the figure of earned surplus or even upon current earnings. One must bear in mind that dividends are not paid out of surplus; they are paid out of assets, and usually out of the most liquid of assets, cash. If the company's current position is not strong (and this may be the case even with large earnings), dividend payment may well be inadvisable despite a large figure of earned surplus.

A distribution to stockholders, then, should be governed by the condition of assets and liabilities, the current requirements of the business, and its probable future needs. A corporation may be in a position where it can afford to distribute cash to its stockholders though it may have little earned surplus; another company with large earnings may not find it advisable to deplete its working assets by a dividend payment.

Until recently the laws governing corporations made an effort to prevent the payment of dividends except from accumulated earnings. Then came the various no-par stock laws, which precipitated argument as to the legality of dividend payments chargeable to paid-in surplus. The latest development is the large freedom now granted by the Delaware law which leaves the matter of distribution to stockholders entirely in the hands of the directors, with almost no legal restriction.

The thought back of this evolution may well be that it is impossible to legislate virtue or good judgment. In the final analysis, the success of a corporation depends upon the ability, judgment and good faith of the management. If the board of directors is not competent to determine when a corporation is in a position to afford an expenditure or distribution to its stockholders, legal restriction upon dividend payment cannot save the business. If the board is unscrupulous and deliberately abuses its powers under the new freedom, so as to jeop-

ardize the corporation's financial position with excessive dividend payments, it is exceedingly doubtful if a law forbidding payment of dividends out of capital would either prevent the evil or furnish the cure.*

With regard to the investor who receives the dividend, it is questionable if he is in exactly the position commonly believed. It is true that, to the original subscriber for stock, his investment is identical with the pro rata share of paid-in capital attributable to his stock. To him, all dividends paid from earnings are profits, and any paid out of capital are a return of investment. But to the investor who buys his stock in the market after its original issue, there is usually little relation between his investment and the capital out of which the corporation is ordinarily forbidden to pay dividends. To this investor any dividend other than one paid out of profits earned subsequent to his purchase of the stock is in effect a return of capital. Thus, a speculator may buy a stock at $250, hold it one day and receive a dividend of $20, selling his shares immediately thereafter for $240. The dividend may be a distribution of profit so far as the corporation is concerned, but it is a return of capital to this particular stockholder, at least to the extent of 50% of the dividend.†

The points here suggested in connection with dividends, surplus, and profit are raised for the purpose of indicating that the proposed procedure of charging off plant assets against capital surplus and stating earnings without depreciation may not have the revolutionary effect upon either the theory or the practice of dividend distribution which might at first appear. They are also intended to show that the procedure need not necessarily stimulate ruinous dividend policies in the case of corporations which, under the old legal restrictions, would be models of good management. Finally, it was intended to bring out the fact that many of the phrases so glibly used, as dividends paid out of surplus, dividends out of capital, and dividends which are a return of capital to the stockholder, are by no means the exact terms they are believed to be, nor are they always thoroughly understood or carefully used when they form the basis for objection to the proposed procedure.

Another phase of the question which requires consideration has to do with the recording of addition to fixed assets. The handling of cost of replacements required to maintain plant operating efficiency has already been discussed; but what procedure may be followed when plant facilities are actually expanded by the purchase of additional equipment or properties?

The controlling factor determining the procedure in such cases should be the condition of the capital surplus and earned surplus accounts. It must be borne in mind that the decision to write down fixed assets to a nominal value at a certain time does not constitute an irrevocable election to follow the practice in connection with subsequent additions to asset accounts. The original write-down in value was made when capital surplus was available for the purpose. Subsequent additions to as-

* It is to be noted, however, that laws prohibiting the payment of dividends excepting from profits have been enforced against directors, as for example in the American Malting Company case.—*Editor.*

† In considering the restriction on payment of dividends, the rights of creditors, and not only those of stockholders, are to be considered.—*Editor.*

sets may, in the interest of consistency, be written off against capital surplus if sufficient remains for the purpose, but such a write-off does not necessarily follow merely because of the previous appropriation for revaluation of assets. It is a separate and distinct question of policy upon which the directors should pass, having in mind the condition of the surplus accounts at the time.

There are at least three possible lines of procedure. If sufficient capital surplus is available, it may be appropriated to provide for the reduction to nominal value. This has the advantage of being consistent with the previous action and of maintaining uniformity in the balance sheet.

The second possibility is the appropriation of earned surplus for the reduction in value, provided there is a sufficient accumulation of earnings to justify that step. Such a procedure would be identical with the common write-off of good-will or patent value.

Finally, the newly acquired assets may be carried at ordinary book value; that is, at cost less reserve for depreciation as the latter accumulates. This procedure results in balance sheet valuation of fixed assets upon two different bases, and is somewhat awkward and undesirable for that reason; however, if the facts are plainly disclosed in the balance sheet to avoid any mistaken impression that book value of these new assets is intended to represent the full value of all fixed assets, the method will serve satisfactorily. One fact may be brought out forcibly thereby. If the stockholders' investment is not sufficiently large to absorb the write-off of fixed assets and leave a substantial balance, such a set-up draws attention to the fact and indicates that the stockholders' equity in working capital is a comparatively narrow margin.

It may readily happen that the cost of additions to the patents or plant assets will exceed the capital surplus and/or earned surplus available to absorb the proposed write-down in value; in such a case, only the last of the three foregoing alternatives is feasible. If the directors desire to adhere to the policy of nominal valuation, surplus must be provided for the purpose, and it may be desirable to do so through additional sales of stock.

Stock may be sold with the idea of replacing in the business the funds used in purchasing the new property. If this is desirable from the standpoint of maintaining working capital unimpaired and is practicable in view of conditions in the security market, the stockholders and directors may solve the problem in this manner. Obviously, however, no one would advocate the sale of additional stock solely to provide paid-in surplus for writing down assets. Unless other considerations favor stock issuance, this procedure would not be followed.

The Accountant's Viewpoint

The discussion of the question so far has been for the purpose of stating the case which may be urged in favor of the nominal valuation of fixed assets and the elimination of depreciation from the operating statement. There would seem to be much to indicate that the procedure may be carried on with technical correctness. Assuming that all arguments advanced in its favor do establish the practice as technically correct, what is the responsi-

bility of the accountant and what should be his attitude?

The accountant's opinion that the practice is or is not good business policy cannot control and is to be considered only as he may be called upon for, or feels impelled to offer, advice. The decision to write off fixed assets, to segregate paid-in capital into capital stock and surplus, and to pay dividends out of paid-in surplus, when permitted by law, rests with a corporation's management. The accountant's problem is the presentation of the facts after the situation has been created. Two phases of his problem require consideration. First, what must he insist upon as a minimum requirement, and, second, what will he recommend as the desirable practice?

Obviously, there should be full disclosure of the facts in the balance sheet and operating statements. True, a trained analyst will take notice of the procedure from the mere absence of customary items and realize that so-called net profit is not what he and business men generally have been accustomed to consider as net profits. Omission may put a reader on notice, but the omission itself is not informative and, moreover, all who read financial statements are not trained analysts.

Nor can there be any valid objection to full disclosure. If the practice is technically sound and if it arrives at the correct result, an honest business organization cannot be hurt by having attention drawn to the procedure used. On the other hand, if the organization feels that it gains an advantage through not directing attention to the practice, is it not likely that the advantage is gained because readers fail to notice that the statements are not upon the customary basis?

As a minimum requirement, the accountant should insist upon a statement in the balance sheet, as a footnote or otherwise, that plant value as stated is after writing off book value of plant assets directly against surplus at a given date; because, unless otherwise indicated specifically, plant assets are assumed to be shown at cost less accumulated provision for depreciation computed upon the customary basis of periodical provision from the date of acquisition.

In the income account, the cost of goods sold and the net profit figure should both bear a notation to the effect that they are stated without the inclusion of a depreciation charge. Custom and accepted practice have established the deduction of a current amount of depreciation from gross profits in the income account, and the omission of depreciation should, therefore, be noted as a departure from the established practice.

So much for minimum requirements. What may the accountant advise if his recommendations are requested? It would seem that the accountant should be no less conservative than the stable, conservative element of reputable business men. Earlier paragraphs have indicated what is likely to be the view of the conservative element in financial circles. The accountant's advice may well coincide with these views.

In the balance sheet, the greatest amount of information and the fullest disclosure may be set forth by a presentation somewhat as follows:

Plant and equipment (at cost)	$1,000,000.00
Less provision for depreciation	300,000.00
	700,000.00
Less reserve for plant revaluation, established (date)	699,999.00
Book value.........	$1.00

Here the desired result is obtained, the asset being shown at the nominal value, and, in addition, the data which the analyst and statistician desire are given, with full disclosure of all pertinent facts. It may be repeated here that the plan contemplates depreciation currently computed but charged against the reserve for revaluation instead of against earnings. As an alternative, the periodic depreciation charge may be made against earnings in the ordinary manner, with the corresponding credit to a reserve for depreciation. The revaluation reserve would be reduced by the exact amount of the period's depreciation charge, with a corresponding credit to earned surplus, in order to keep the sum of the reserve for revaluation and reserve for depreciation at $1.00 less than the balance of the asset account.

In the income account, the amount of omitted depreciation should be included in the notation attached to the cost of goods sold and the net profit figures, to the effect that they are stated without the inclusion of a depreciation charge, and whether or not the earnings have been made to bear the cost of replacements intended to maintain the plant at its original efficiency.

The ultimate solution of the problem may lie in the development and elaboration of a statement which at present is not given the importance it deserves, i.e., the analysis or reconciliation of surplus. Commercial bankers, investment brokers, and the financial public should require the completion of the financial picture given by the balance sheet and operating statement by demanding a third statement which analyzes the net worth.

The accountant may develop a "Statement of Capital" based upon the present surplus reconciliation so as to give a brief but comprehensive history of the net worth of the corporation. Prepared with the idea of being of greatest value, this statement would include a summary analysis of the capital, setting forth the amounts paid in, the allocation of paid-in capital to surplus, the total earnings added to surplus, the total dividends paid, the charges representing write-down of plant assets, and, finally, a detailed statement of changes in surplus for the period covered by the accompanying income account.

Any of the foregoing suggestions should be acceptable to the client who desires to deal frankly and honestly with all who may read his statements. If the purpose of the nominal valuation plan is the balance sheet presentation primarily—the establishment of a hidden reserve and the elimination of a book value of assets which might be misleading—this purpose is accomplished, for none of the procedures suggested for presenting earnings will interfere with the balance sheet structure. If the primary purpose of the nominal valuation is to increase a figure called earnings, through the exclusion of depreciation, then the plan is unsound and misleading and should be opposed by progressive accountants who recognize their responsibilities.

Annual Firm Meeting

The annual meeting of the partners and managers was advanced to September 16, 1929 this year inasmuch as a goodly number of the partners were in New York City at that time because of their attendance at the International Congress on Accounting which had just adjourned.

A game of golf in connection with the holding of this meeting now seems to have become an established institution. This year the members of the firm and managers were afforded the privileges of the Blind Brook Golf Club at Greenwich, Conn. The participants were favored with a delightful day. After the scores had been counted up, and the handicaps figured, it was found that the Lybrand cup had once again moved to another L. R. B. & M. office.

In 1927 it found its first resting place at Seattle when Mr. Don S. Griffith, the manager of that office, was the winner. Last year the cup was brought to Washington through the successful efforts of Mr. J. Marvin Haynes, manager of that office. This time Philadelphia office wins the honor through the good work of its representative, Mr. A. Karl Fischer, who, in the terms of golf, shot a 67 (net of his handicap). The New York office had the questionable honor of maintaining for the second year the "booby" prize, through the excellent (?) work of Mr. N. B. Bergman, who had the highest gross score of all participants, and in deference to whose feelings we do not print the score. An excellent luncheon was served at the Club, and the party reconvened at the Union League Club in New York for dinner and for a discussion of questions of accounting policy of current interest.

Among the subjects considered were (1) the treatment of stock dividends received by investment trusts, especially as related to the recently promulgated listing rules and Committee report of the New York Stock Exchange; (2) the reconcilement of audit procedure of American subsidiaries in foreign countries with the procedure for domestic corporations in the United States, and (3) the preparation and certification of income statements with respect to depreciation where a corporation has elected to charge off its plant assets.

The discussion of these subjects was entered into enthusiastically by all present, and was only limited by the fact that a number of those present were obliged to make train connections around midnight. The discussion of the second subject was made especially interesting through the participation by Mr. L. V. Norris, manager of our London office, and Mr. F. O'Dea, manager of our Berlin office, who had come to the United States at this particular time for the double purpose of attending the annual firm meeting and the International Congress on Accounting. Before returning to their posts abroad they will visit a number of our offices in this country.

The L. R. B. & M. Journal

Published by Lybrand, Ross Bros. and Montgomery, for free distribution to members and employees of the firm.

The purpose of this journal is to communicate to every member of the staff and office plans and accomplishments of the firm; to provide a medium for the exchange of suggestions and ideas for improvements; to encourage and maintain a proper spirit of cooperation and interest and to help in the solution of common problems.

Audit Procedure

The Federal Reserve Board has recently issued a revision of its earlier publication dealing with the preparation, verification and certification of balance sheets and income statements. This revision is based, as was the earlier edition, on the report of a committee of the American Institute of Accountants. The full text of the committee report appeared in the May, 1929, issue of the *Journal of Accountancy*. The revised procedure is now obtainable in pamphlet form and each of our offices has a supply of copies.

The June, 1929 issue of *The American Accountant* contained a "Critical Review of New Pronouncement on Verification of Statements" written by Mr. Sweet of our firm. This article reviews the pamphlet in some detail, expressing approval of some of the suggestions it contains and questioning others.

In the course of his article Mr. Sweet states that

> The auditor should look upon the program of verification as a reminder, in general terms, of the scope and mode of verification to be generally applied, but subject nevertheless to more or less adaptation in each examination according to his judgment after he has learned the state of the company's accounts, records, and organization. As the report states in two places (1 and 113), "the responsibility for the extent of the work required must be assumed by the auditor". If he adopts a more limited examination than the report lays down, he "must always be prepared to justify his departure".

Every member of our staff should acquaint himself with the contents of the revised pamphlet. A careful reading of Mr. Sweet's article will also be found decidedly helpful.

An Arguable Question

In the recent past several security offerings to the public have been based on bankers' prospectuses, the balance sheet in which included the fixed property of the issuing company at a net value of $1. Subsequently published earnings statements or income accounts of such companies include no depreciation allowances and the net income is thus stated at a figure in excess of that which would be shown if the normal method of determination were followed.

Figured from the standpoint of conventional practice, this method produces the anomalous condition of an ultraconservative balance sheet on the one hand and an overstated income account on the other. To be sure, by proper description or qualification the reader of such statements may be put on notice that they have not been prepared along wholly conventional lines and that they must be read and considered with especial care if wrong impressions are not to be gained therefrom.

It must be recognized that there are a good many angles to the question of whether this method is a desirable one from the standpoint of the stockholder or investor, or whether it contains fallacies which lead to misleading impressions and wrong conclusions. In an endeavor to develop a helpful discussion of the subject, Mr. Boedeker, of our Los Angeles office, has written an article for this issue of our Journal in which he presents the arguments which may be made for the validity and propriety of the method referred to.

It is not to be understood that Mr. Boedeker is advocating its general use but rather that he is developing one side of the subject for consideration. The editor of the JOURNAL will be glad to receive one or more articles which present the other side of the subject and bring out any fallacies or weaknesses which make the use of the method undesirable.

International Congress on Accounting

(Continued from page 8)

ber of the members of the firm and staff of L. R. B. & M. attended this banquet, and spent a most enjoyable evening. In the course of the evening Mr. E. van Dien, of Amsterdam, Holland, who was President of the Second International Congress of Accountants, and who had been present at the first Congress, held in St. Louis in 1904, read off a list of the members present at the St. Louis Congress. He specially mentioned the fact that Mr. Staub, who won the prize for his winning paper on "The Mode of Conducting an Audit" at the time the first Congress was held in St. Louis, was also present at the third Congress together with Mrs. Staub and some of their children.

One of the incidental social features of the Congress was a dinner tendered by our firm to the members of the L. R. B. & M. organization who had come from offices outside of New York to attend the Congress. A number of the members of our New York staff were also present. About sixty in all attended the dinner which was held at the Hotel Commodore on the evening of September 13th. It was an occasion of pleasant contacts which should stimulate better acquaintance between the various offices of the firm.

The proceedings of the Congress will be issued in book form, and the

papers contributed will form a part of the volume. Owing to the very instructive character of the contents of this volume and their permanent value, it is recommended to all members of the staff that they secure possession of the volume for use as a part of their studies in accountancy.

Budgets—Their Organization and Administration

(*Continued from page* 6)

budget committee headed by the president of the company or the general manager. This committee and the budget officer should review and revise the estimates in order to secure a well-balanced program. After it has been adopted the committee should meet at least as often as statements of the operating results are available for comparison with the budget. In this connection it is interesting to note that some companies make comparisons only with the budget and not with the results of the past. This is due to the fact that the budget has been carefully prepared from a review of current possibilities and is therefore a safer test of performance than figures from the past which may have been affected by conditions which no longer exist. However, a comparison with both budget and past results would seem desirable. It is important not merely to know whether the goal established by the budget has been fully realized, but also how actual performance compares with what has been previously accomplished.

At the end of the first month, a comparison may show that sales made during the month are thirty per cent less than the estimated sales and indications are that an even greater decrease is likely to occur the second month. The sales budget should, therefore, be revised and all other budgets changed to correspond insofar as such changes are possible. Or the comparisons may show that while sales are being made as programmed, production has fallen down. Therefore, the sales budget will have to be decreased because of inability to fill orders.

When you consider the wonderful opportunity that a budget affords to test plans before they are undertaken; to measure the success of plans that have been undertaken; to coordinate the activities of all departments of a business, and to control expenses, it seems rather astonishing that budgets are not in more general use.

Now that I have concluded my paper, I want to say that I think the title of the subject assigned to me for discussion would be more appropriate for a book than this paper. This subject is too vast and it has too many ramifications for me to cover it adequately at this meeting, so do not hesitate to bring up for discussion points that I have failed to mention.